

Microreinsurance applications: Filling supply and demand gaps

Briefing Note

The potential size of the global microreinsurance market is estimated somewhere between US\$6 billion and US\$12 billion in ceded premium. An untapped market of this size warrants significant attention from the reinsurance community, given downward global trends in commercial reinsurance and other pressures on top-line growth.

Put simply, reinsurance is insurance for insurance companies. Every peril that can be insured can be reinsured. Not all perils demand the same degree of reinsurance, however. Large, stable portfolios of small risks with reasonably similar and small sums insured and/or broad geographic spread tend to need less risk transfer than, say, a small portfolio of highly concentrated and very large risks. Generally, reinsurance arrangements in microinsurance consist of one or more of the reinsurance products shown in Figure 1.

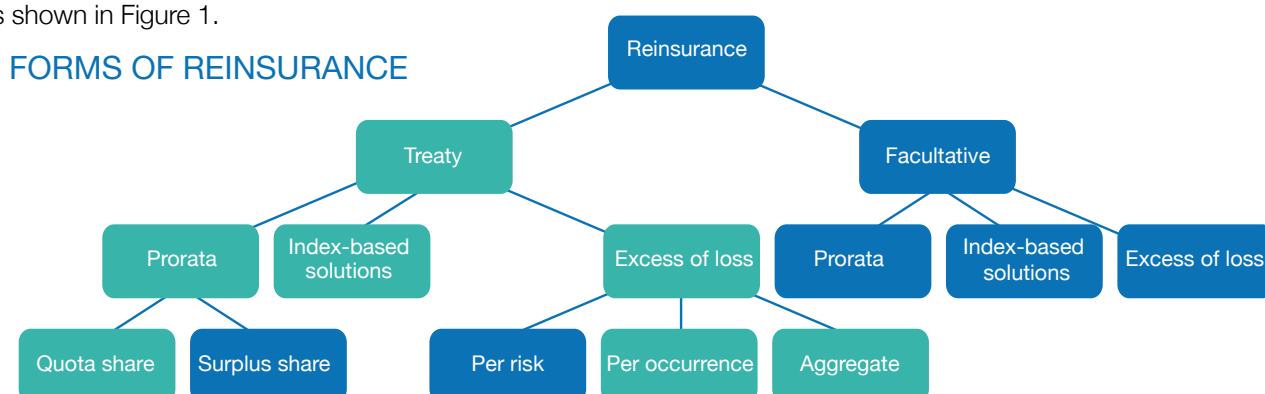


Figure 1. Basic forms of reinsurance. The green boxes are most relevant to microinsurance.

EXCESS OF LOSS PER OCCURRENCE

Reinsurance is most in demand from small programmes in relatively complex and catastrophe-prone lines of business. Supply on the other hand is most readily available to large programmes in relatively simple lines of business. The Latin American Reinsurance Group (LARG) housed at the International Cooperative and Mutual Insurance Federation (ICMIF) addresses this mismatch. LARG consists of 16 members, all of which are insurance cooperatives based in Latin America. Each member struggled to access non-life reinsurance independently, owing to its relatively small size and perceived lack of sophistication. With assistance from the ICMIF and other stakeholders, the individual insurers developed the LARG consortium that purchased reinsurance products including property catastrophe excess of loss; per risk, motor and miscellaneous working cover excess of loss. LARG is an excellent example of how risk pooling can be used effectively by small insurers (formal, informal or otherwise) to achieve cost-efficiencies by increasing the exposure volume, geographic diversity and administrative simplicity of a subject portfolio.

EXCESS OF AGGREGATE LOSS

Aggregate excess of loss (XOL), sometimes referred to as “stop loss” arrangements, are reinsurance contracts that provide annualized protection to insurers (Figure 2). Such arrangements need to be designed carefully to ensure that incentives are aligned across all partners.

Non-Proportional / Excess of Loss Reinsurance

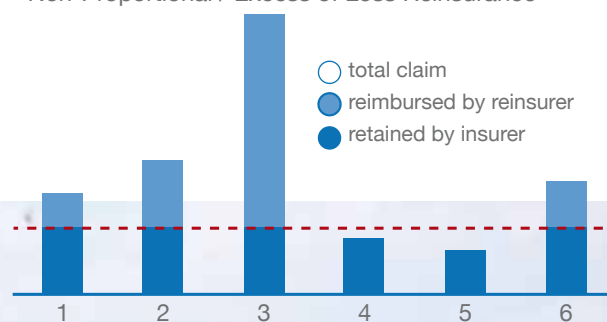


Figure 2. Excess of loss reinsurance in six distinct claim scenarios. The reinsurance coverage only kicks in above a certain claim level.

When the Aga Khan Agency for Microfinance (AKAM)'s insurance partner was worried about the risk of mispricing and high claims for its health microinsurance scheme in Pakistan, AKAM partnered with an international reinsurer to provide a stop loss cover for 90 per cent of claims. The insurer retained 10 per cent of the risk. Since majority of losses were ultimately paid by AKAM, local stakeholders were not influenced by the risk of underwriting losses and were incentivized to increase sales and provide generous healthcare to their communities rather than control claims costs.

INDEX-BASED SOLUTIONS

The supply of microreinsurance has primarily focused on index-based catastrophe insurance. In 2011, the Microinsurance Catastrophe Risk Organisation (MiCRO) provided catastrophe insurance to 58,000 borrowers of the microfinance institution (MFI), Fonkoze. MiCRO provided index-based cover based on rainfall, wind speed and seismic activity. MiCRO also provided basis risk protection: if payout based on the index trigger was not sufficient to cover actual losses of the borrowers, MiCRO covered 85 per cent of the difference, up to US\$ 1 million per year. The actual loss was based on an assessment of clients' losses conducted by Fonkoze. Overall, MiCRO paid out nearly US\$ 9 million in claims to Fonkoze in its first two full years of coverage, well over the amount of associated premium collected. As Fonkoze was not fully insured for the total value of the product, it absorbed a significant portion of the losses facing sustainability challenges. As MiCRO expands to other countries, it will need to adapt its model to reflect the lessons learned in Haiti on sustainability and scalability.

Housed at the International Labour Organization, the Impact Insurance Facility enables the insurance industry, governments, and their partners to realise the potential of insurance for social and economic development. The Facility was launched in 2008 with generous support from the Bill & Melinda Gates Foundation, and has received subsequent funding from several donors, including the Z Zurich Foundation, Munich Re Foundation, the IFC, USAID and AusAID. See more at: <http://ilo.org/impactinsurance>